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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS & COPPER CO., INCORPORATED,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the Court of Appeal of California,
First Appellate District

BRIEF OF THE FINANCIAL EXECUTIVES INSTITUTE AND THE TAX EXECUTIVES INSTITUTE, INC., AS AMICI CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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This brief is submitted with the written consent of counsel to both parties filed with the Clerk of the Court.

INTEREST OF THE AMICI CURIAE

Financial Executives Institute ("FEI") is a non-profit, individual membership, professional organization composed of approximately 10,000 corporate executives who are responsible for the development of fi-

nancial policy and the administration of the financial affairs of some 5,000 companies, large and small, in the United States, Canada and Puerto Rico. The companies with whom FEI's members are associated represent a broad cross-section of American business and industry and they conduct a significant portion of the nation's interstate commerce.

One of the primary objectives of FEI is to provide a means for its members to make joint studies and recommendations on matters of broad financial significance, including developments in state and local taxation which significantly affect business or the environment in which it operates.

The specific interest of FEI in this case is that the decision of which review is now sought constitutes a serious inroad upon the well established rules that a state may not tax out-of-state corporations upon income not in any way attributable to activities within the taxing state, and that common ownership alone does not justify state taxation of an in-state corporation upon the basis of income earned by an out-of-state, independent, affiliated corporation.

In view of the essential role these constitutionally based principles have played in the proper growth and development of the nation's interstate commerce, the potential consequences of the present decision are of the gravest concern to FEI, the business community, and the nation as a whole.

Tax Executives Institute, Inc. ("TEI") is a nonprofit organization whose membership consists of approximately 3,200 corporate and other business executives, managers and administrators who are responsible for the administration of the tax affairs of their

employers. TEI's membership represents approximately 1,800 business organizations, nearly all of which engage in interstate commerce. A prime objective of TEI is to promote uniform enforcement of taxes throughout the nation and thereby to minimize the costs of administration and compliance for the benefit of government and taxpayers alike.

TEI represents persons who bear the responsibility and burden of complying with the decision of the Court of Appeal of California which is at issue in this case. In view of the administrative difficulties and uncertainties created by that decision, TEI and its members have a direct and special interest in the outcome of this case.

ARGUMENT

This case presents an issue of pervasive importance under the Commerce and Due Process Clauses—whether a state may apply the so-called unitary approach and levy tax by reference to the combined net income of an affiliated group of corporations, even though only a single member of the group does business within the state, and even though that member's income is neither more nor less than it would have been in the absence of the affiliation. Here, in imposing its franchise tax (measured by net income) on appellant Chase Brass & Copper Co. ("Chase"), which operates in California, California has included in the tax base net income earned by Chase's parent, Kennecott Copper Corporation ("Kennecott"), and other Kennecott companies, which do not operate in California. It has done so solely by reason of the fact that Kennecott owns the controlling interest in Chase and the other companies, for the trial court specifically found (J.S.

App. A at 7 [1]) that the income-earning activities of Chase and the other corporations were at all times separate and distinct, and that Chase's business activities were not so inter-related with the business activities of the other out-of-state corporations "as to make possible the earning of income by Chase or any of the others . . . not properly reflected on each's separate books of accounts." The trial court further found (*Ibid.*) that:

> Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership.[2]

Only last Term this Court reaffirmed that the Commerce Clause limits the power of states to tax activities in interstate commerce, *see Boston Stock Exch.* v. *State Tax Comm'n,* 429 U.S. 318 (1977), and announced that the constitutionality of a state tax is to be determined not by resort to formalistic labels, but by whether the tax produces a forbidden effect, *Complete Auto Transit* v. *Brady,* 430 U.S. 274, 288 (1977). To pass constitutional muster under the Due Process and Commerce Clauses, a direct tax on interstate activity must be justified by a substantial nexus between the activity taxed and the taxing state, must be fairly apportioned, must not discriminate against interstate commerce, and must be fairly related to services provided by the taxing state. *Id.,* at 279-287. California's tax at issue here is constitutionally impermissible on all of these grounds. If allowed to stand, the decision below sustaining this tax provides a ready method by which states may circumvent the Due Process and Commerce Clause protections which have been essential in facilitating the growth of the nation's economy in an environment complicated by the varying and often conflicting tax systems of the fifty states. The attempt by California to reach the combined incomes of the Kennecott affiliated corporations is typical of the recent pattern of state efforts to stretch taxing powers in order to reap an ever-larger share of the profits of multicorporate entities.[3] Because so much of the nation's interstate commerce is conducted by multicorporate entities, it is vitally important that the Court note jurisdiction in this case in order to clarify the constitutional limitations upon a state's power to tax such entities.

1. The effect of applying California's unitary allocation formula in this case—the taxation of income earned in other states—has been uniformly forbidden by the decisions of this Court, "both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due." *Norfolk & W. Ry.* v. *Missouri State Tax Comm'n,* 390 U.S. 317, 325 (1968). This Court

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[1] "J.S. App." references are to Appendices to the Jurisdictional Statement.

[2] These findings distinguish this case from other apportionment cases in which the income-earning activities of corporations, or divisions of the same corporation, are inter-related. *See, e.g., Butler Bros.* v. *McColgan,* 315 U.S. 501, 507-10 (1942).

[3] Recent state efforts to utilize overly favorable apportionment formulas in order to increase revenues from the taxation of interstate activities are not limited to the multicorporate situation. *See, e.g., Moorman Mfg. Co.* v. *Bair,* No. 77-454, *probable jurisdiction noted,* November 14, 1977.

has unequivocably held that, "[a] State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders.'" *Id.* (citation omitted). *See also, Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123 (1931); *Wallace* v. *Hines,* 253 U.S. 66 (1920). The applicability of this long established restriction to the tax imposed here, and the wisdom of continuing to apply this restriction, are inescapable.

The decision of the Court of Appeal in this case sustains a wholly extra-territorial tax on out-of-state income earned by out-of-state corporations. Unless reversed by this Court, it means that henceforth with respect to the great majority of multicorporate entities the states are no longer subject to the constitutional limitation that they may tax only activities and values within their borders. It thus removes the most fundamental safeguard against multiple taxation of interstate business.[4]

2. Equally important, by arbitrarily imposing upon corporations with out-of-state affiliations a substantial tax burden not imposed upon corporations without such affiliations, California is discriminating against multi-

[4] The danger of multiple taxation is all too clear in this case. California included in Chase's tax base approximately $5,000,000 of out-of-state income earned by one Kennecott subsidiary even though that subsidiary had already paid the State of Rhode Island tax on its entire net income. Similarly, the State of Utah had imposed its own version of the "unitary" business concept upon Kennecott, but the Court of Appeal of California merely stated: "[T]he Utah decision is not controlling as to this court; also, it is based on the application of separate accounting principles to the unitary business, which are contrary to the laws of this state. . . ." J.S. App. D at 39-40.

corporate entities and against the interstate commerce of which those enterprises are a significant part. This Court has repeatedly held that no state may, consistent with the Commerce Clause, "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." *Boston Stock Exch.* v. *State Tax Comm'n, supra,* at 329, quoting *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 458 (1959). *See also, Halliburton Oil Well Co.* v. *Reily,* 373 U.S. 64 (1963); *Nippert* v. *Richmond,* 327 U.S. 416 (1946); *I.M. Darnell & Son* v. *Memphis,* 208 U.S. 113 (1908). Nor may any state "build up its domestic commerce by means of unequal and oppressive burdens upon the industry and business of other states." *Guy* v. *Baltimore,* 100 U.S. 434, 443 (1880). Here, the discrimination is obvious because multicorporate entities based entirely within California are not subject to the state's "unitary" or "combined reporting" method.[5]

3. The tax upon the income of Chase's corporate affiliates also offends the Due Process Clause because it is in no way justified by any nexus between the taxing state and the income-producing activities of the foreign corporations or by any services offered by California to out-of-state multicorporate entities. Any conclusion that the incomes of Chase and its affiliates are "unitary" in the sense of being inter-related finds no support in the facts of this case as stipulated by the parties and found by the trial court. Whatever the justification for this method of apportionment in other situations, utilization of the unitary method in this

[5] *See Handlery* v. *Franchise Tax Board,* 26 Cal. App. 3d 970, 103 Cal. Reptr. 465 (1972), *appeal dismissed,* 410 U.S. 921 (1973).

case flies in the face of the constitutional requirement that state taxes be fairly apportioned to reflect income-producing activities within the state.

Nor can the result reached by the Court of Appeal below be justified by the convenient incantation that it is a permissible "rough approximation" of the income produced by Chase in California.[6] Application of the formula in this case resulted in a seven-fold multiplication of Chase's income for the three-year taxable period. This Court rejected a similar "rough approximation" in the *Norfolk & W. Ry.* case, *supra,* where the allocation method applied resulted in a multiplication of the value of the taxpayer's property by only as much as two and one-half. In doing so, the Court stated (390 U.S. at 327):

> Our decisions recognize the practical difficulties involved [in apportionment] . . . but our cases certainly forbid an unexplained discrepancy as gross as that in this case. Such discrepancy certainly means that the impact of the state tax is not confined to intrastate property even within the broad tolerance permitted. The facts of life do not neatly lend themselves to the niceties of constitutionalism; but neither does the Constitution tolerate any result, however distorted, just because

[6] The Court of Appeal placed reliance on the "rough approximation" language of *International Harvester Co.* v. *Evatt,* 329 U.S. 416 (1947), to support its decision. That case is inapposite to this one, however, because it involved a specific finding that the state tax was not being imposed upon sales made outside the state and that the purpose of the formula was to arrive at a fair value of the intrastate business of a single taxpayer. *Id.*, at 421-423. There is no indication in *International Harvester* that the Court intended to allow a state to use "rough approximation" to tax the extra-territorial incomes of separate corporate entities not otherwise subject to the state's taxing powers.

> it is the product of a convenient mathematical formula. . . .

4. Finally, the decision of the California Court of Appeal, extended to its logical conclusion, would allow California to tax corporations operating within its boundaries upon the basis of income earned outside the United States by their foreign affiliates. Indeed, California has already applied its combined reporting requirement to Canadian companies operating within California (although not in this particular case). The logical extension of California's application of the unitary business concept therefore threatens to interject the states improperly into the delicate area of international trade and business relations.[7]

If permitted to stand, the decision of the Court of Appeal of California will impede the orderly growth of

[7] This problem was noted in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the United States House of Representatives, which recommended:

> In keeping with the basic structure of our Federal System, the Committee is of the view that international tax policy should be formulated by the Federal Government and not by individual states.
>
> • • • • • •
>
> Likewise, no State would be allowed to require that such income [from sources outside the United States] be included in the consolidated income of a multicorporate enterprise for apportionment purposes.
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> H. Rep. No. 952, Vol. 4, p. 1155, 89th Cong., 1st Sess. (1965).

Although this case does not directly involve the taxation of income earned outside the United States, the foregoing consideration illustrates the grave danger of allowing the states to tax extra-territorial activities under the guise of seeking to apportion the income of multicorporate enterprises.

interstate commerce by creating an atmosphere of uncertainty respecting the power of the states to tax multicorporate entities. The decision renders impossible a fair apportionment of revenue among the states as each will compete for a larger share without regard to the traditional restriction that they may not tax activities and values outside their borders. Immediate correction by this Court is required if this result is to be avoided.

CONCLUSION

For the foregoing reasons it is submitted that the decision in this case raises substantial and serious questions under the Commerce and Due Process Clauses of the Constitution; presents issues of great importance to the nation's commerce; and is patent in its error. *Amici curiae* accordingly urge the Court to note probable jurisdiction and grant a plenary hearing on the merits.

Respectfully submitted,

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